



Impact of IMF Loan on Pakistan's Economy In long run and short run

MAY 24

Authored by: Ayesha Majid



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IN LONG RUN AND SHORT RUN

At a Glance

2019 Projected Real GDP (% Change)
: 2.9

2019 Projected Consumer Prices (% Change): 7.6

Country Population: 204.729 million

Date of Membership: July 11, 1950

Article IV/Country Report: July 13, 2017

Outstanding Purchases and Loans (SDR): 4153 million (April 30, 2019)

Special Drawing Rights (SDR): 269.22 million

Quota (SDR): 2031.0 million

Number of Arrangements since membership: 21

Country Data

Real GDP growth (Annual percent change) ⁱ	2.9
Inflation rate, average consumer prices (Annual percent ... ⁱ	7.6

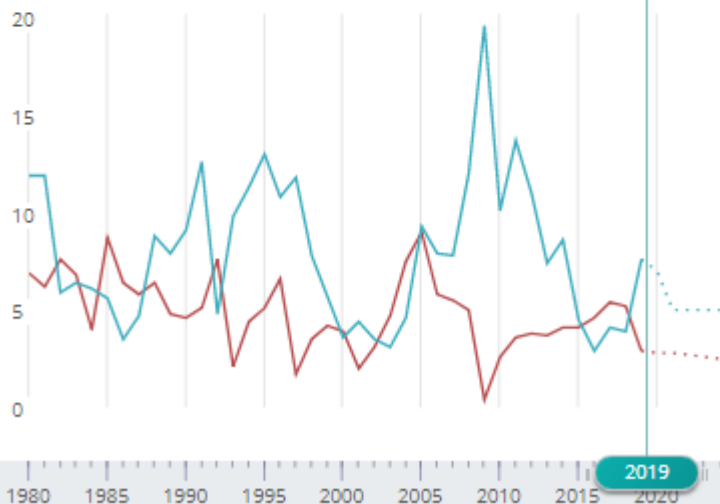


Figure 1: Economy of Pakistan

Source: IMF DataMapper, April 2019 ▶

For decades, Pakistan has had chronic problems collecting tax and the program envisages reforms to improve public finances and cut public debt. However, failing to cope with these issues Pakistani government had to resort to taking loan. Hence under leadership of Prime Minister Imran Khan the government signed loan agreements with Saudi Arabia, United Arab Emirates, China & IMF.

To keep the balance of payments in check and to meet the financial obligations government of Pakistan unfortunately always resort to take loans hence the government has now resorted to IMF.

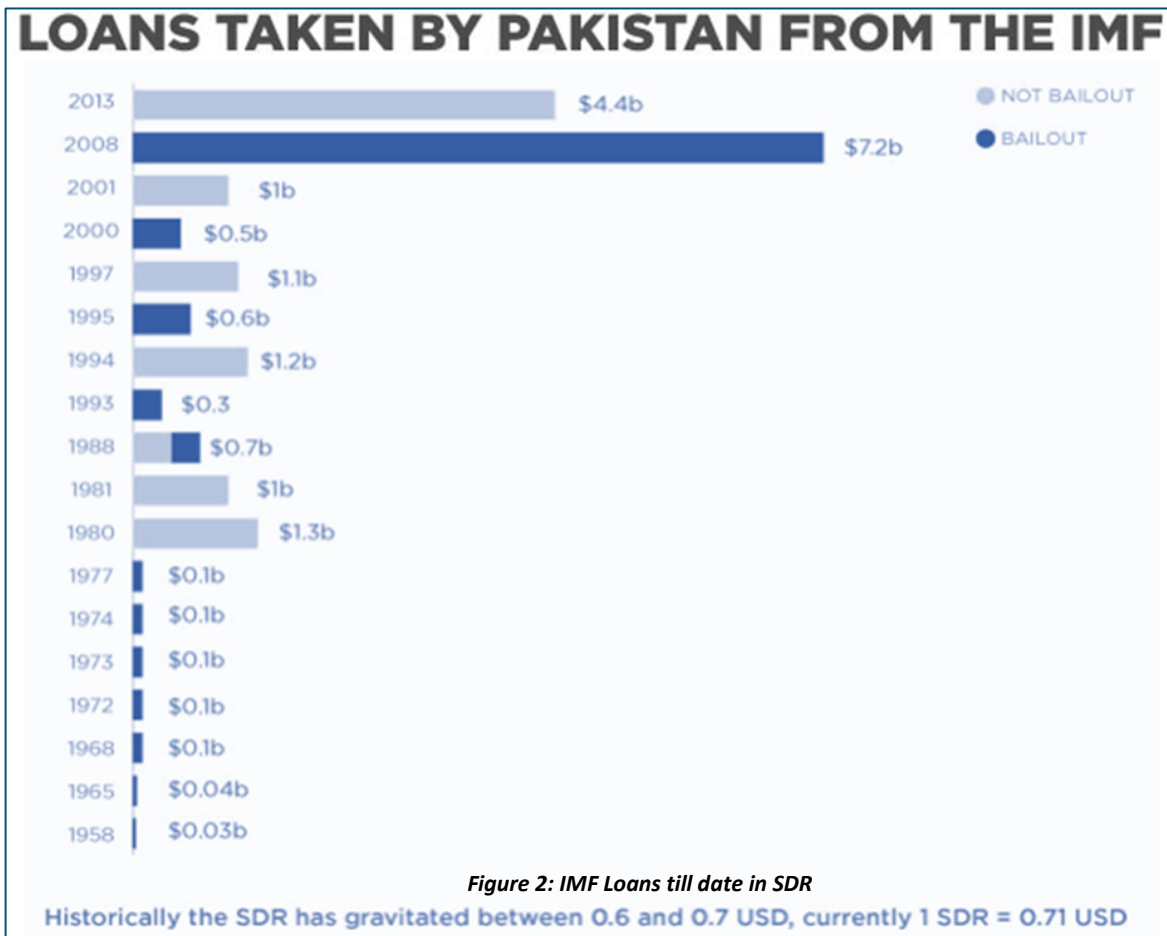
The primary purpose of taking loans from the IMF is that Pakistan's Government wants to stabilize its deteriorating economy,

exchange rates and balance of payments, however this relief is short-term and usually yields a new crisis in long-term as the debt matures and the government gets into a

monetary crisis again due to inadequate raising of dollar in the federal reserve. IMF provides huge amount of loans for such purposes, which seems very lucrative and attractive offer at first sight for a short-term perspective.

“Entering the programme was essential because it would allow you to raise money from the other avenues, It gives an assurance to all the other players in the market that now you can support Pakistan because it’s getting disciplined- Saad Bin Ahmed” (Hasan, 2019)

Pakistan and IMF have signed 22 agreements for loans since 1958 comprising of 10 programs under PRGT (Poverty Reduction Growth Trust) and GRA (General Resource Account) of IMF and 12 bailouts. The current 39-month bailout plan has raised the figure by \$6 billion and is the 13th time Pakistan has gone to IMF since 1980’s. A part of the bailout will be utilized to pay back policy loans from the World Bank and the Asian Development Bank.



This bailout has laid several conditions on the Pakistani government including those on taxes and subsidies, government spending, interest rate and foreign exchange rate but the most stringent condition laid by IMF for Pakistan was to account in detail the Chinese financial outlay in China Pakistan Economic Corridor and give firm assurances that Pakistan will not divert IMF loans to service its China debts. Pakistan needs \$12 billion this year to bridge the gap between its foreign currency holdings and what is required to pay for loans and imports.

The IMF wants us to raise our revenue income by Rs700 billion in the first year of the 39-month-long programme. The IMF will closely monitor the implementation of these reforms on a quarterly basis. In a situation of default in the implementation process, the IMF can stop the next tranche of the loan to Pakistan. This means that the promised \$6 billion would not flow as a lump sum amount. It will be paid in several installments. (Ayaz, 2019)

The State Bank of Pakistan (SBP) released data showed that the **total debt and liabilities** went up from **Rs 25.109 trillion** till June 2017 to **Rs 29.861 trillion** on June 30 2018 and **Rs 35.094 trillion** till end March 2019 , indicating that the total debt increased by Rs 4.752 trillion in last financial year 2017-18 and went up by Rs 5.2 trillion in first nine months of this fiscal year, showing 17.4% growth over the debt level of June 2018. Pakistan's foreign exchange liabilities doubled to \$10 billion by March, an

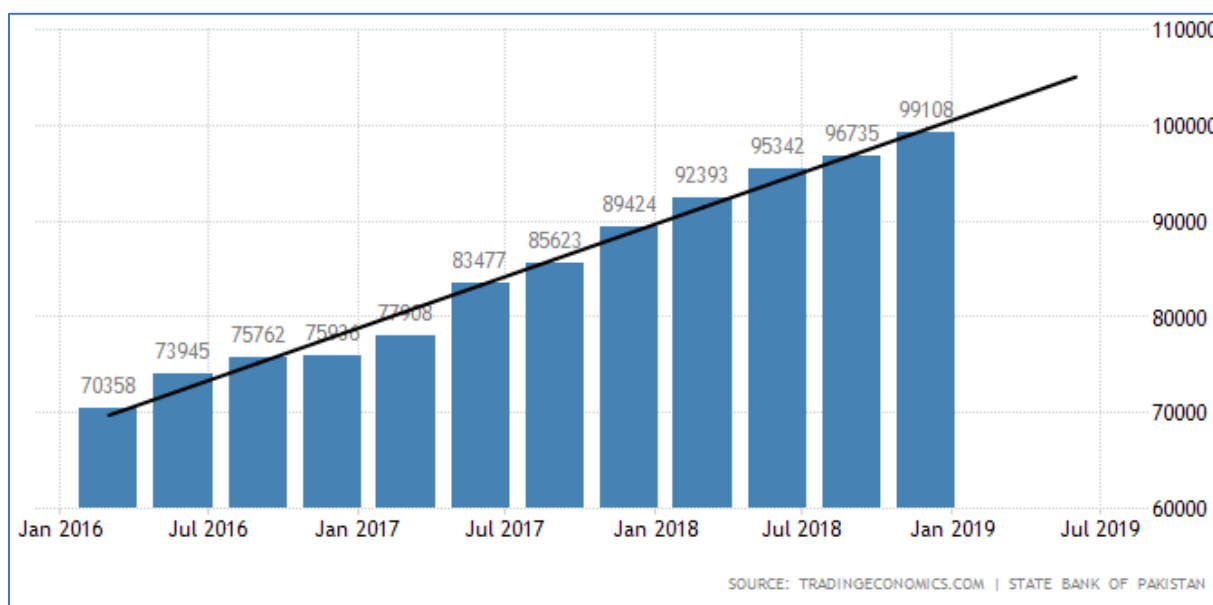


Figure 3: Pakistan Total External Debt

addition of \$5 billion since June 2018. The central bank's deposit-related liabilities increased to \$5.7 billion from \$700 million.

External Debt in Pakistan is expected to be 105000.00 USD Million by the end of this quarter, according to Trading Economics global macro models and analysts' expectations. Looking forward, we estimate External Debt in Pakistan to stand at 115000.00 in 12 months' time. In the long-term, the Pakistan Total External Debt is projected to trend around 123000.00 USD Million in 2020, according to our econometric models. (Trading Economics, 2019)

The country owes debt to Paris Club (\$11.3 billion), multilateral and other donors (\$27 billion) and international bonds such as Eurobond and sukuk (\$12 billion). In total foreign and domestic debt is predicted to rise to Rs2.1 or Rs2.2 trillion for the outgoing fiscal year ending on June 30, 2019. Meaning debt-to-GDP ratio galloping to 70%, and burdening every Pakistani citizen with \$982. the finance ministry spends 36% of the total budget to service the public debt.

"Pakistan is facing a challenging economic environment, with lacklustre growth, elevated inflation, high indebtedness, and a weak external position" Ernesto Ramirez Rigo, who led the I.M.F. mission to Pakistan (Amir, 2019)

After IMF the biggest donor to Pakistan is China. An estimate is that around \$19-20 billion out of \$90 billion total debt and liabilities of Pakistan is Chinese i.e. over one fifth of the overall debt. Surpassing Japan to become the single biggest bilateral lender to Government of Pakistan. China also happens to be the biggest lender to the private sector as well. There is no direct number to reach the Chinese loan to Pakistan private sector; but virtually all the increase in the last three years has come from China. The total private sector external loan increased from \$3 billion in Jun15 to \$7.2 billion in Dec17. Pakistan will have to payback \$100 billion to China by 2024 of total investment of \$18.5 billion, which China has invested on account of bank loans in 19 early harvest projects, under CPEC.

Debt from China		
(\$ bn)	17-Jun	Source
China bilateral debt to Pakistan	7.2	From SBP annual report
Currency swap	1.5	From SBP annual report
Central bank deposits	0.7	From SBP annual report
ICBC Pakistan branch loan	2.7	ICBC Pakistan branch report
Private sector - non guaranteed debt	3.5	Estimated \$3.5 billion out of \$4.2 billion private sector debt in last 30 months are from China
Debt liabilities to direct investors	1.5	Estimated \$1.5 billion of China Mobile
Total	17.1	
<i>Figures are based on Jun-2017</i>		

Figure 4: Debt from China (BR Research, 2018)

Although CPEC has the potential to transform the Pakistani economy, but experts fear this transformation could come at heavy price for Pakistan in light of what has happened in the past.

Pakistan will have to payback \$100 billion to China by 2024 of total investment of \$18.5 billion, which China has invested on account of banks' loan in 19 early harvest projects mostly relating to energy sector under CPEC. The interest on these loans will be around 7% per annum payable in 25 to 40 years. This means Pakistan would have to pay China roughly in between \$7-8 billion as EM for the next 43 years from 2018 onwards. (Khan, 2017)

According to Centre for Global Development, in 2011, Tajikistan wrote off an unknown amount of loan owed to China in exchange of 1,158 square kilometers of land. And this was only 5 percent of the land what was demanded by Chinese. Then in Sri Lanka, China did a debt to equity swap against \$8 billion loan at 6 percent provided for construction of Hambantota Port against 99 years lease for managing port. Hence for Pakistan this loan could mean losing the Gwadar port to china but only time can tell what actually will happen will Pakistan be able to repay the loan or will it have to swap the loan for land or equity with China.

Pakistan has been warned not to underestimate the economic risks from its China-funded building projects Chief economist Maurice Obstfeld says the debt-ridden country should carefully examine its dealings with China as it heads for another bailout. (Yu, 2018)

CPEC brought development and business avenues with it in Pakistan in exchange of the loan from Chinese government. In the same way IMF loan is expected to enable Pakistan to repay its maturing loans, boost its dollar reserve, acquire dollars to pay its import bill and cure the soaring economy from the money received.

Possible measures include raising taxes, reducing energy subsidies and selling state companies, while the IMF is also in favor of a “market-determined” exchange rate. (Mangi, 2019)

Due to the terms and condition of the loan Pakistan will see a new tax culture/regime, enhancement in foreign exchange reserve and increased creditability rating of the country through reduction in default rate risk of Pakistan. However to achieve all of this Pakistanis will have to pay the cost in the form of devaluation on Pakistani rupee, freezing of expenditure on non-developmental government activities (e.g. subsidy on electricity and gas, expenditure of civil departments and federal ministries), decline in economic activity hence decline in GDP and allied economic indicators, a rise in markup rate and cost of inter-bank transactions, and increase in central excise duty on service and agriculture sector.

One area where the IMF has put a lot of focus is tax collection. Pakistan has for years struggled to raise its tax revenue and increase its tax net. *Under the understanding, the government will start withdrawing exemptions offered in various taxes amounting to around Rs350bn in the budget for 2019-20... the government will have to reduce subsidies and take Rs340bn from consumers in the energy sector... the demand of the IMF for an increase in the policy rate by 100-200 basis points was also agreed upon...* (Pakistan Today, 2019)

Under the agreement the rupee value will be set on free-float so that its real value in dollar and market value equates in the long run, since rupee's value decreased by 17% even though the State Bank was stabilizing the value for past two years to artificially inflate the rupee. This stance has resulted that the rupee has almost lost 21 per cent of its value against the dollar from Rs123 to Rs150 in the past nine months.

That IMF plan caused a significant economic slowdown and the former finance minister (Sheikh) faced a major challenge in managing a slowing economy. The economy requires 7 to 8 per cent growth to lift the country out of poverty and fully absorb the growing labour force. (Fazl-e-Haider, 2019)

The main aim of IMF is to increase revenue of the borrowing countries but in case of Pakistan they have not been able to do much in the past.

The depreciation of one rupee adds Rs105.8 billion to the public debt. Similarly, a 1% increase in interest rate increases the cost of debt servicing by roughly Rs180 billion. This ultimately increases borrowing requirements for the finance ministry. The central bank increased the interest rates by 1.5% aimed at fulfilling the prior condition of the International Monetary Fund (IMF) for qualifying \$6 billion bailout package. It will add over Rs260 billion in the debt servicing cost of the finance ministry on the existing stock of the debt. (Rana, 2019)

In the long run the IMF plan hints towards an even bigger financial crunch of the economy than it is facing today. The debt taken by Pakistan from the IMF increased in rupee terms by Rs70 billion to Rs811 billion due to currency devaluation. Hence in the long run IMF Loan has the potential to harm Pakistan and its economy in a more devastating and brutal way than the loan taken from China under CPEC. Since there are very slim chances that Pakistan will make most benefit out from the positive impact on exchange rate in the long run.

Multiple IMF programmes, including the last which ended in 2016, haven't helped Pakistan deal with weaknesses that have led to the balance of payments crisis. The last programme did help boost foreign exchange reserves for a time and made Pakistan's capital markets attractive to foreign investors. (Hasan, 2019)

Whether the program turns to be beneficial or detrimental for the economy depends how the public responds to the measures and how thoughtfully the government implements it for now the government has no other option but to take the loan so that they can prevent the financial structure of the country from collapsing. The current economic condition of Pakistan and the future agenda of the government indicates that Pakistan has fallen in a debt trap. Pakistan's debt and liabilities have risen steeply to Rs35.1 trillion or 91.2% of size of the economy. Yet the government is indicating to take more loan especially from IMF and Friendly countries.

This time, IMF has made it clear that the staff-level agreement of \$6 billion is subject to “timely implementation of prior actions and confirmation of international partners’ financial commitments.” That means that FBR will have to show how it wants to increase the revenue in the next budget. The State Bank will have to ensure that the rupee-dollar parity is now being set on the basis of the free market float and increase the primary lending rates. Hence there are more chances that the plan will not only be beneficial in short run but also in the long run as well due to the IMF pressure.

Since Pakistan had no other option but to take loan from IMF because foreign exchange reserves were barely enough to cover two months of exports and inflation climbing to over 8 percent. So that it can shore up fragile public finances and strengthen a slowing economy hence we should focus on how to make the most benefit from the plan that IMF has given than debate on the merits and demerits of the loan and image a better deal that could have been struck if the government negotiated. The most worrisome part of the package is what will happen when these loans will mature as in 2022 IMF 13th bailout will mature, in 2023 Saudi Arab’s loan (\$9.6Bn) and UAE’s loan (\$6.2Bn) will mature, in 2024 china’s loan (\$100Bn) will mature.

Saudi Arabia would postpone demand for payments of \$275m a month for the next three years, totalling \$9.6bn- Abdul Hafeez Shaikh. The Saudi payments deferral follows Riyadh’s decision in October to grant a \$6bn loan to Mr Khan’s government in October 2018 (Bokhari & Findlay, 2019)

UAE package involves \$3.2bn worth of oil supplies on deferred payment of upto 3 years, besides a \$3bn cash deposit. (Dawn News, 2019)

Table of Figures

Figure 1: Economy of Pakistan	2
Figure 2: IMF Loans till date in SDR	2
Figure 3: Pakistan Total External Debt	2
Figure 4: Debt from China (BR Research, 2018)	2

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